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PEAK OF MONEY RATES MAY BE IN SIGHT

THE currentuptrend in money rates, which has lifted borrowing costs to the highest level in a generation, may be at or near its peak. While some further tightening in credit cannot be ruled out, particularly during the busy fall season, the weight of the evidence points to one conclusion: whenever it may occur, the next major swing in interest rates will be sideways, then downward.

This view, it is worth noting, has been voiced in recent weeks in the most authoritative quarters. In early August, for example, Randolph A. Burgess, retiring Undersecretary of the Treasury, told the Senate Finance Committee that he thought "it was about an even bet" that interest rates will drop in the next year or so. Testifying before the same group not long afterward, William McChesney Martin, chairman of the Federal Reserve Board, remarked that he is "inclined to think we are reaching a leveling out process where interest rates may stabilize and even decline." Just the other day, Carrol M. Shanks, president of Prudential Insurance Co., observed that interest rates have gone about as high as they are likely to go.

To be sure, the experts have been wrong before. As Mr. Shanks admitted wryly, he made the same forecast several months ago, just before the last big bulge in yields. Nonetheless, a hard look at the present state of the money market tends to support such views. First and most obviously, interest rates lately have climbed to a point where, by prewar as well as postwar yardsticks, they are no longer low. On September 6, to illustrate, the Treasury had to pay 3.575% on 91-day Bills, highest figure since the bank holiday of 1933. In its August refunding operation, the Treasury sold a 2-to-4 year Note at better than a 4% yield. The last time it has to pay as much on such a security was in May of 1923. As to business borrowing, today's prime rate of 4½% actually is higher than it looks. For in order to qualify for this rate, the borrower generally must maintain a compensating deposit balance roughly equivalent to 20% of his indebtedness, an arrangement which works out to an effective cost of 5-5/8%. Sooner or later, what goes up is apt to come down.

These high rates, of course, reflect the very heavy demand for money. In the first eight months of 1957, to illustrate, State and local governments borrowed over $4.5 billion, or 21% more than in the corresponding period of last year. In August alone, municipal financing totaled $575 million, compared to $213 million in August of 1956, the largest figure ever recorded for the month. Similarly, sales of new corporate security issues in January-August ran to an estimated $8.4 billion, against $6.6 billion in the like 1956 period.

Moreover, such offerings are likely to continue at a very brisk clip. Thus, last week nearly $350 million worth of new corporate securities came to market. Large issues of A. T. &T., and its subsidiaries, are scheduled for next month, and a sizable backlog of deferred municipal financing has built up.

At the same time, the supply of loanable funds, notably savings, has been disappointing. True, according to most official estimates, savings this year are running at least on a par with last year. However, the global figures tend to obscure a significant - and, in terms of the money market, an ominous - shift in U. S. thrift habits. As noted here in March, there has been a perceptible swing away from such institutions as savings banks, savings and loan associations, and even insurance companies, and toward commercial banks and direct security investments.

A few figures underscore the point. In the first seven months of 1957, total deposits in mutual savings banks rose by less than $900 million, compared to $1,080 million in the corresponding months of 1956. Again, in January-June savings and loan associations reported a gain of only $2,557 million in savings capital accounts, 11% less than the year-ago figure. In July alone, the S & Ls actually suffered a net loss of nearly $90 million for the month, an event which has occurred only twice before - right after the outbreak of World War II and the Korean conflict - in the past 16 years. Finally, some life insurance companies, notably the Metropolitan, report an increase in policy loans and surrender of policies for cash, a trend which also has taken money out of the investment stream.

This shift may be reversed in coming months. After a long delay imposed by the State banking authorities, savings banks in New York State, a major thrift area, now have raised their rates to depositors. By the same token, the Federal Home Loan Bank Board, in an effort to spur the flow of funds into savings and loan associations, has proposed several changes in its regulations. In the near future, the associations will be permitted to pay special premiums and bonuses to those who save on a regular basis. In any case, other shifts are taking place which promise to ease the tightness in money.

One of these is the changing position of the Treasury. In the first half of 1957, perhaps as never before in its history, the Treasury found itself strapped for cash. This year it actually had to borrow in March, at a time when tax receipts run heaviest. Several of its subsequent offerings, moreover, were received so poorly that they cast a pall over the market. To some extent, the shadow still remains. In coming weeks the Treasury will have to borrow another $3 billion, including more than $1 billion of new money. However, once this financing is out of the way, the Treasury (barring some unforeseen contingency) will make no further extraordinary demands upon the market for the rest of the year. Thus, temporarily at least, one of the most unsettling elements in the monetary picture will be removed.

A nearby peak in money rates is also indicated by the continued lag in bank lending. In the first 34 weeks of 1957, business loans of the weekly reporting FR member banks have increased by less than $1 billion, compared to $2.6 billion

in the like period of last year. Total loans have risen by only $287 million, against $2.8 billion a year ago. Since midyear, furthermore, instead of taking off on their customary seasonal upswing, business loans actually have declined.

The chances are that as fall progresses, the gap will grow wider. Last year, it will be recalled, heavy demands were made on commercial bank credit, most notably from oil companies interested in acquiring foreign concessions in Venezuela. In addition, unlike last fall, when inventory building of new cars was in full swing, businessmen are likely to add little if anything to their stocks. Indeed, a liquidation of inventories is long overdue. All in all, commercial banks this fall are apt to find themselves with a greater supply of credit available.

A third straw in the wind is the attitude of the Federal monetary authorities. Last month Chairman Martin made it plain that he is determined to check inflation. Nonetheless, he was at some pains to emphasize that once a business downturn begins, the Federal Reserve System will move swiftly to ease credit. This view is held even more strongly by some influential members of the System, notably the head of the Federal Reserve Bank of New York, who raised the rediscount rate to $3\frac{1}{2}$% only with reluctance and after a 10-day delay. At the very least, the monetary authorities can be counted on to show a willingness to supply credit to meet seasonal needs. If these fail to match expectations - as apparently happened over the Labor Day weekend - the reserve position of the banks could become still easier.

In the mortgage market, too, forces appear to be working in the same direction. First, volume of home loans has been declining sharply all year. In the first six months of 1957, nonfarm mortgage recordings of $20,000 or less amounted to $11.8 billion, a decline of more than 12% from the $13.5 billion of 1956. The slide, moreover, appears to be picking up speed. In June alone, the year-to-year gap exceeded 16%. As a consequence, it now seems likely that total mortgage recordings in 1957 will run to no more than $22-$23 billion, against $27 billion in 1956.

So sharp a drop was made all the more likely by passage of the Housing Act of 1957. Among its mischievous provisions was one compelling FHA to set up "reasonable" discounts on Government-underwritten mortgages. As decreed last month, the discounts generally run to 1-2 points on the new 5-1/4% FHA rate ($2\frac{1}{2}$ points in such remote mortgage areas as Arizona, Idaho, Nevada, Hawaii, and the Virgin Islands). FHA also has been authorized to limit discounts on advance commitments and standbys.

While it is too early to be conclusive, the immediate reaction of lenders has been highly adverse. According to one New York City mortgage firm, the consensus among his clients is that the terms just barely fall within today's interest rate curve. If money should tighten by as little as 10-15 basis points, the rigid rate, coupled with the rigid discount, might well leave FHA mortgages high and dry. Quite apart from yield, lenders are perturbed over the affidavits and other paper work now involved in dealing with FHA. In short, the discount regulations are likely to result in a lower volume of FHA loans. The VA program is virtually

dead. Taken together, these facts point to the possibility of an artificial scarcity of U. S.-underwritten liens at some future time.

Finally, recent months have seen at least the beginnings of several long-range approaches toward channeling more funds into home mortgages. For example, FHA not long ago changed its rules to permit lenders to dispose of partial interests in FHA-insured liens through the issuance of notes, participation certificates or other forms of security. The change is expected to make it easier to tap the huge reserves of the pension funds.

In addition, the Federal Home Loan Bank Board is actively considering ways and means of luring fresh intermediate - and long-term capital into residential mortgages. According to Albert J. Robertson, chairman of FHLBB, one plan calls for establishing within the System a secondary market facility for conventional mortgages. A more startling proposal was unveiled last month on behalf of the U. S. Savings and Loan League by Sen. John Sparkman of Alabama. Just before Congress adjourned, Sen. Sparkman introduced a bill to establish a Home Loan Guarantee Corp., the purpose of which would be to provide partial Federal insurance for conventional mortgage loans.

Specifically, the plan calls for insurance coverage up to 20% of the top portion of conventional loans made by the FHLB system and other lenders who might participate. Coverage of the top 20% would be on a 90/10 coinsurance basis. It would further provide a maximum ratio of loan to value of 90%; maximum maturity of 25 years; maximum loan covered of $20,000 and no limitation on interest rates.

To illustrate, on a single-family home appraised at $10,000, a maximum $9,000 loan could be made. The insured part would be 90% of the top 20% ($1,800) or $1,620. The lender would take the risk on $7,380 ($7,200 plus $180 - the top 10% of the top 20%). Any loss in the insured part would be shared, with the lender assuming 10% and the Home Loan Guarantee Corp. up to 90%. Cost to the borrower or lender would be a single premium of 5-10% of the amount insured.

The proposal, which is slated to be considered in Washington next year, has evoked the following pertinent comment from William F. Keesler, senior vice president of the First National Bank of Boston. Said Mr. Keesler: "The general idea seems good . . . but its success is dependent on good administration that may not have as favorable a period to operate in as VA and FHA have had since their inception. There is not much question in my mind that in order to be sound, it would require more experienced and intelligent mortgage underwriting than many of the newer banks across the country are equipped to give."

Regarding mortgage lending as a whole, Mr. Keesler struck an equally pertinent note. Said he: "There is a joint responsibility shared by the lenders, the builders and the ultimate owner to help develop that type and quality of construction which is economically sound, and to discourage further development where it is not healthy or fully warranted by evident permanent need." In the waning summer of 1957, after more than a decade of continued inflation, his words seem timely indeed.